



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

Draft

Date Amended:	01/07/02	Bill No:	AB 1185
Tax:	Sales and Use	Author:	Mountjoy
Board Position:	Support	Related Bills:	AB 1199 (Cardenas)

BILL SUMMARY

This bill would provide an ongoing partial sales tax exemption of 6 percent for the sale of any article of clothing or footwear sold for \$200 or less for a 7-day period ending every last Thursday in August.

ANALYSIS

Current Law

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail in this state. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted.

Under current law, sales of clothing and footwear are generally subject to the sales or use tax to the same extent as any other sale of tangible personal property not otherwise exempted or excluded by statute. However, Section 6375.5 of the Sales and Use Tax Law provides an exemption for sales of new children's clothing when sold to a nonprofit organization for its distribution without charge to elementary school children.

The rate of tax currently applicable to retail sales of clothing and footwear is made up of various components:

- 4 3/4% percent state tax allocated to the state's General Fund (Section 6051, 6051.3, 6201 and 6201.3).
- 1/2 percent state tax allocated to the Local Revenue Fund which is dedicated to local government for program realignment (Section 6051.2 and Section 6201.2)
- 1/2 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Sec. 35 of Article XIII of the California Constitution).
- 1 1/4 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- 1/8 to 1 1/4 percent Transactions and Use Tax which is allocated to special taxing jurisdictions in various counties and cities within the state (Part 1.6, commencing with Section 7252).

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Proposed Law

This bill would add Section 6397 to the Sales and Use Tax Law to provide a partial tax exemption (6%) for the sale of any article of clothing and footwear purchased for \$200 or less for a 7-day period ending on the last Thursday in August. This bill would also provide the following:

- The proposed exemption would *not apply* to sales of any special clothing or footwear that is primarily designed for athletic activity or protective use and that is not normally worn except when in use for the athletic activity or protective use for which it is designed.
- The proposed exemption would *not apply* to accessories such as sales of jewelry, handbags, book bags, backpacks, luggage, umbrellas, wallets, watches, and similar items carried on or about the human body.
- The proposed exemption would *not apply* to rentals of clothing and footwear.

The bill would specify that a “sale” includes both layaways and any exchange of an article of clothing or footwear if the article is exchanged for a like article of equal or lesser value, i.e., a shirt for a shirt.

This bill would specify that the exemption shall not apply to the Bradley-Burns Uniform Local Sales and Use Tax or the Transactions and Use Tax.

The bill would become effective immediately.

Background

This proposed law is modeled after a similar law in New York State. Sales of clothing and footwear are exempt from tax in New Jersey, and many residents of New York went to New Jersey to purchase their clothes. To help discourage this, New York State implemented a law in 1997 allowing for a one-week exemption from the tax for the sales of clothing valued under \$100. The State of New York was pleased with the results, so it added two additional one-week exemption periods in 1998 and also raised the limit from \$100 to \$500. New York again had the one-week exemption periods during 1999, and a permanent exemption for sales of clothing under \$500 will become effective in 2000. Other states that have enacted a sales tax holiday for clothing and/or computers include Florida, Texas, Connecticut, South Carolina, Pennsylvania, Iowa and Maryland. Two “sales tax holiday” measures were considered during the 1999-00 Legislation Session. Assembly Bill 944 (Cardenas), in its last amended form, would have provided an exemption for clothing and footwear purchased for \$100 or less during a 3 day period, and Assembly Bill 1320 (Ashburn) proposed a one-week exemption on purchases of any tangible personal property for less than \$500. AB 944 was held in the Senate Revenue and Taxation Committee, and AB 1320 failed to pass from its house of origin by the deadline. The Board’s position was “neutral” on both measures.

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COMMENTS

1. **Sponsor and purpose.** According to the author's office, who is also the sponsor, the purpose of this measure is to create an exemption for sales of clothing and footwear during a specific period of the year to help ease the financial burden on lower to middle income families when purchasing back-to-school clothing for their children.
2. **January 7, 2002 amendments specify that tax would not apply to specified exchanges and layaway orders placed during the holiday period.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: a rescission of the original sale and a separate sale of the replacement merchandise. As an example, if a customer purchases a medium-sized shirt and exchanges the shirt for a small-sized shirt, the transaction is regarded under the law as a separate sale of the small-sized shirt and a rescission of the original sale of the medium-sized shirt. The retailer is allowed to deduct from his or her taxable sales amount for purposes of reporting the correct amount of sales tax to the Board, the sales price of the medium-sized shirt, and is also required to include in his or her taxable sales amount, the sales price of the small-sized shirt. Using this example, with these amendments, if the medium-sized shirt is purchased during the sales tax holiday period, and is exchanged for the small-sized shirt *after* the holiday period, the proposed exemption *would* apply to the exchange of the small-sized shirt.
3. **A 7-day exemption could increase retailers' costs.** Creating an exemption that only lasts for 7 days would place an additional burden on retailers to have their cash registers programmed to tax sales on certain dates and apply a partial rate of tax on certain dates. This may require retailers to incur costly and frequent reprogramming of their registers to accommodate the change. Also, retailers would be required to segregate sales subject to the 6 percent exemption period from sales before and after that date for purposes of properly reporting their tax obligations to the Board. However, retailers would presumably be compensated for this by increased sales activity during the exempt period.

Based on information in a 1990 report that the Board prepared to determine the impact on retailers costs with respect to implementing a tax increase in 1989, on average, retailers with quarterly prepay accounts spent \$94.35 to reprogram their cash registers and computers and retailers with monthly and quarterly accounts paid \$19.47. Adjusting these figures for an increase in the California Consumer Price Index and the increase in the number of accounts since the 1990 study, it is estimated that retailers incur approximately \$9.3 million in comparable reprogramming costs to implement a rate change.

4. **Exemption applies to sales tax only.** The proposed law would exempt sales of clothing and footwear from the computation of the sales tax, but not the use tax. Therefore, California consumers ordering clothing and footwear from out-of-state, Internet and mail order retailers, for example, would continue to remain liable for the use tax during the holiday period. There could be a constitutional concern with this under the Commerce Clause of the United States Constitution. It could be argued

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that allowing an exemption for in-state purchases while applying use tax to out-of-state purchases discriminates against interstate commerce.

5. **Related legislation.** Another sales tax holiday measure proposed by the Governor was introduced in 2001. That measure, AB 1199 (Cardenas, et al.), would provide a sales tax exemption for the sale of any article of clothing or footwear for \$200 or less, and any computer and related accessories, as specified, sold for \$1,000 or less, during a three-day period in August 2001. AB 1199 would also specify that unless the governing body of a city, county or district votes to not have the sales tax holiday apply to its respective local tax, the holiday would additionally apply to those taxes.

COST ESTIMATE

Some costs would be incurred in notifying affected retailers, answering inquiries and writing appropriate regulations. Because of the partial tax exemption, administrative costs would be incurred in computer programming, return revisions, return analysis, and return processing. A detailed cost estimate is pending.

REVENUE ESTIMATE

As reported by the Department of Commerce, national personal consumption expenditures for clothing and footwear amounted to \$294.6 billion in 1999. We assume that California accounts for 12% of national sales, as California's population is 12% of the total United States population. Sales of clothing and footwear in California were estimated to be \$35.4 billion in 1999.

Taxable sales of apparel and general merchandise stores, the main retailers of clothing and footwear in California, have been increasing annually at an average of 3.8% for the last few years. If we assume that sales of clothing and footwear will increase by 3.5% annually, then estimated California sales of clothing and footwear for 2002 will be \$39.2 billion.

We would expect sales of clothing and footwear to be higher than average for the periods when these sales would be exempt from the sales tax. The state of Texas found that during a week's tax holiday on clothing and footwear, sales were double the normal weekly sales. Based on this information, we assume that the seven-day period involved represents 14/365 (two weeks) of a year's worth of sales. Also, we have not been able to find any information regarding what percentage of clothing and footwear sales are for items priced at \$200 or less. However, if 80% of clothing and footwear sales were for \$200 or less, then sales subject to the provisions of this bill would be as follows:

Annual Sales	Period Percentage	Period Sales	Exempt Percentage	Exempt Sales
(sales in millions)				
\$39,200	14/365	\$1,504	80%	\$1,203

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Revenue Summary

The annual revenue loss from exempting from the state sales tax any article of clothing or footwear purchased for \$200 or less during an annual seven day period would be as follows:

	<u>Revenue Loss</u>
State loss (5%)	\$60.2 million
Local Revenue Fund loss (0.05%)	6.0 million
Public Safety Fund loss (0.05%)	<u>6.0 million</u>
Total	<u>\$72.2 million</u>

Qualifying Remarks

The figures from the Department of Commerce do not include accessories or rentals. Although the Department of Commerce does not have separate figures for special clothing or footwear primarily designed for athletic activity or protective use, we do not believe that the inclusion of these items would materially affect this estimate.

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